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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
 , ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-102794-07
Date: March 30, 2007

Legend:

$$\underline{X} =$$
Trust =

D1 =

D2 =D3 =D4 =State =

Dear _____ :

This responds to a letter dated January 5, 2007, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State on D1, and elected to be an S corporation effective D2. On D3 and D4, shares of the stock of X were transferred to Trust, an ineligible shareholder.

X and its shareholders represent that, although Trust was eligible to elect to be an "electing small business trust" (ESBT) under § 1361, they were unaware of the need to make such an election. X and its shareholders represent that the circumstances resulting in the termination of X's election to be an S corporation were inadvertent. X represents that X and its shareholders have filed federal income tax returns consistent with X's S corporation election. X and each person who was and is a shareholder of X at any time since D3 agree to make such adjustments, consistent with the treatment of X as an S corporation that the Secretary may require.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) provides that the term ESBT means any trust if: (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under this subsection applies to such trust. Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely upon the representations made and the information submitted, we conclude that X's S election terminated on D3, when shares of the stock of X were transferred to Trust. We further conclude, however, that the termination was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on D3, and thereafter, provided that the trustee of Trust files an ESBT election and provided that X's S election was not otherwise terminated under § 1362(d). Trust must file an ESBT election pursuant to the procedures set forth in § 1.1361-1(m)(2) effective D3, with the appropriate service center within 60 days of the date of this letter. Trust must also amend its federal income tax returns consistent with being an ESBT. Trust will be treated as an ESBT under § 1361(e) effective D3. A copy of this letter should be attached to the ESBT election.

X's shareholders must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X to its shareholders as provided in § 1368.

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the code. Specifically, no opinion is expressed concerning whether X was or is a small business corporation or whether Trust is otherwise eligible to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter ruling will be sent to your authorized representatives.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: